

# AN UPDATE ON 3RD QUARTERLY REVIEW OF MONETARY POLICY

**DSP BLACKROCK**  
MUTUAL FUND



**Dhawal Dalal**

Senior Vice President,  
Head - Fixed Income

The Reserve Bank of India (RBI) has announced the following measures after its Third Quarterly Review of Monetary Policy:

- Cash Reserve Ratio (CRR) has been hiked by 75 basis points from 5% in two stages - a 50 basis points starting Feb 13 and 25 basis points starting Feb 27, 2010
- All other rates have been kept unchanged for now

The RBI has also revised its baseline projection for WPI inflation for March 2010 from 6.5% with upside bias to 8.5% and economic growth to 7.5% from 6%.

We believe that the CRR has been hiked to ensure that inflationary expectations percolating in the other areas of the economy due to surplus liquidity condition and higher food price inflation remain well contained. With this hike in CRR, the RBI is expected to reduce surplus liquidity to the tune of Rs. 36,000 crore by Feb 27, 2010. However, the RBI is confident that there will be sufficient amount of liquidity in the banking system after this CRR hike.

While the RBI has been happy to note the steady progress of the economic front, they have noted some clear and present dangers which could tilt the state of balance in the near-term. Some of them are:

- A downturn in the global economic recovery and sentiment
- Strengthening commodity prices - particularly oil and food prices & their impact on the inflation front
- Higher fiscal deficits and huge government borrowing programs

In light of these, the RBI's Policy tone is "measured" while the Policy Stance has shifted from "managing the crisis" to "managing the recovery" while anchoring inflationary expectations during this uneven economic recovery environment.

## What it means to the Market?

We believe that the RBI has taken a first step towards unwinding the "accommodative stance" and moving towards a "neutral stance". The next step may be to raise Reverse Repo Rate (currently at 3.25% pa) as well as Repo Rate (currently at 4.75% pa) in the near-term. In light of that, its impact on the fixed income market can be summarized below:

- **Liquidity Conditions:** Current surplus liquidity in the banking system is around Rs. 70,000 crore. This may drop to around Rs. 34,000 crore by Feb 27, 2010. Surplus liquidity will drop further in the month of March on account of last tranche of Advance Tax Payment as well as disinvestments of PSU companies by the government in order to raise at least Rs. 25,000 crore offset the likely delay in the receipt of 3G license fees
- **Money Market Rates:** We expect a gradual tightening of money market rates. We expect short-term rates to have higher impact in response to reduction in the surplus liquidity. We also anticipate a sudden increase in the supply of money market assets as borrowers may decide to borrow now in anticipation of tight liquidity conditions in the horizon. Overall, we believe that money market rates will inch up by at least 20 to 25 basis points in the near-term in a gradual manner

- **Government Bonds:** We see some headwinds facing the government bonds. On one hand, there is little supply pressure due to scheduled borrowing coming to end in the first week of February and better sentiments for bonds having a positive impact on the bond prices. On the other hand the rising fiscal deficit could temper bullish sentiments. The 3G auction postponed to the next fiscal and volatile equity market conditions creating some headwinds, there is still a chance that the government may have to resort to extra borrowing to the tune of Rs. 10,000 crore to Rs. 15,000 crore either by way of dated securities or Cash Management Bills. The bond market is also keenly watching the Union Budget for the indication of the next year's Gross Borrowing Program (approximately Rs. 4,50,000 crore anticipated). Overall, we believe that the benchmark 10Y bond yield may touch 8% pa in the first-half of 2010.

### What should an investor do?

We believe that investors should consider investing in low duration and high quality fixed income funds such as DSP BlackRock Strategic Bond Fund and DSP BlackRock Floating Rate Fund in the first-half of the year. As further monetary steps by the RBI may push money market rates higher, a low duration fund will not only protect the portfolio from the likely price risk but will also generate decent risk-adjusted returns. Investors with an appetite for volatility should consider investing in high duration funds such as DSP BlackRock Bond Fund and DSP BlackRock Government Securities Fund around July 2010 when bond yields are likely to peak out, in our opinion.

**DSP BlackRock Strategic Bond Fund (DSPBRSBF)** is an open ended income scheme, seeking to generate optimal returns with high liquidity through active management of the portfolio by investing in high quality debt and money market securities. **Asset Allocation:** Money market securities and/or Debt securities with residual or average maturity of less than or equal to 367 days or put options within a period not exceeding 367 days: 0% - 100%; Debt securities which have residual or average maturity of more than 367 days: 0% - 100% (Debt Instruments may include securitised debts up to 75% of the net assets). **Features:** Minimum investment: Regular Plan - Rs. 5,000/-, Institutional Plan - Rs. 1 crore. Declaration of NAV on all Business Days. Entry/Exit Load - Nil. Redemption normally within 3 Business Days. Nomination facility available, subject to applicable conditions as per the Statement of Additional Information (SAI) and Scheme Information Document (SID). **DSP BlackRock Floating Rate Fund (DSPBRFRF)** is an open ended income Scheme, seeking to generate interest income through investments in acceptable floating rate assets commensurate with the credit risk. The Scheme may also invest in fixed rate debt securities. **Asset Allocation:** Floating rate debt securities\* or money market securities: 65% to 100%; Fixed rate debt securities: 0% to 35% (Debt securities may include securitized debts upto 60% of the net assets). **Features:** No entry/exit load. Sale and redemption of Units on all Business Days at Purchase Price and Redemption Price. Switching facility subject to prevailing terms of the scheme. SWP and STP facilities available in each plan of the scheme. Minimum investment - Regular Plan - Rs. 5,000; Institutional Plan - Rs. 5 crore. Declaration of NAV on all Business Days. Redemption normally within 2 Business Days. Nomination facility available, subject to applicable conditions as per the Statement of Additional Information (SAI) and Scheme Information Document (SID). **DSP BlackRock Bond Fund (DSPBRBF)** is an open ended income Scheme, seeking to generate an attractive return, consistent with prudent risk, from a portfolio which is substantially constituted of high quality debt securities, predominantly of issuers domiciled in India. As a secondary objective, the Scheme will seek capital appreciation. **Asset Allocation:** Debt & money market securities: 100% (Debt securities may include securitised debts upto 50% of net assets). **Features:** Sale and redemption of Units on all Business Days at Purchase Price and Redemption Price. Switching facility subject to prevailing terms of the scheme. SIP, SWP & STP facility available. Minimum Investment - Rs. 5,000/- . Exit Load - Holding Period <= 7 calendar days: 0.10%; Holding Period > 7 calendar days: Nil Declaration of NAV on all Business Days. Redemption normally within 3 Business Days. Nomination facility available, subject to applicable conditions as per the Statement of Additional Information (SAI) and Scheme Information Document (SID). **DSP BlackRock Government Securities Fund (DSPBRGF)** is an open ended income Scheme, seeking to generate income through investment in Central Government Securities of various maturities. **Asset Allocation:** Central Government securities, repos / reverse repos in Central Government securities as may be permitted by Reserve Bank of India: 80%-100%; Call money market or alternative investment for call money market as may be provided by the Reserve Bank of India: 0%-20%. **Features:** Sale and redemption of Units on all Business Days at Purchase Price and Redemption Price. Switching facility subject to prevailing terms of the scheme. SIP, SWP and STP facilities available. Minimum investment - Rs. 5,000/- . Entry Load: NIL; Exit Load: Holding Period <= 7 calendar days - 0.10%, Holding Period > 7 calendar days - Nil. Declaration of NAV on all Business Days. Redemption normally within 2 Business Days. Nomination facility available, subject to applicable conditions as per the Statement of Additional Information (SAI) and Scheme Information Document (SID). **Statutory Details:** DSP BlackRock Mutual Fund was set up as a Trust and the settlors/sponsors are DSP ADIKO Holdings Pvt. Ltd. & DSP HMK Holdings Pvt. Ltd. (collectively) and BlackRock Inc. (Combined liability restricted to Rs. 1 lakh). Trustee: DSP BlackRock Trustee Company Pvt. Ltd. Investment Manager: DSP BlackRock Investment Managers Pvt. Ltd. **Risk Factors:** Mutual funds, like securities investments, are subject to market and other risks and there can be no assurance that the Scheme's objectives will be achieved. As with any investment in securities, the NAV of Units issued under the Scheme can go up or down depending on the factors and forces affecting capital markets. Past performance of the sponsor / AMC / mutual fund does not indicate the future performance of the Scheme. Investors in the Scheme are not being offered a guaranteed or assured rate of return. Each Scheme/Plan is required to have (i) minimum 20 investors and (ii) no single investor holding >25% of corpus. If the aforesaid point (i) is not fulfilled within the prescribed time, the Scheme/Plan concerned will be wound up and in case of breach of the aforesaid point (ii) at the end of the prescribed period, the investor's holding in excess of 25% of the corpus will be redeemed as per SEBI guidelines. **DSPBRSBF, DSPBRFRF, DSPBRBF and DSPBRGF are the names of the Schemes and do not in any manner indicate the quality of the Schemes, its future prospects or returns.** For scheme specific risk factors, please refer the Scheme Information Document (SID). For more details, please refer the Key Information Memorandum cum Application Forms, which are available on the website, [www.dsblackrock.com](http://www.dsblackrock.com), and at the ISCs/Distributors. **Please read the SID and SAI carefully before investing.**